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Golden Parachutes: A Perk that Boards Should Scrutinize Carefully

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COMMENTS

GOLDEN PARACHUTES: A PERK THAT BOARDS SHOULD SCRUTINIZE CAREFULLY

I. INTRODUCTION

In 1981 United States industry was dramatically transformed by a record-breaking[1] 2,313 merger transactions with a total value of seventy-three billion dollars.[2] Tender offers[3] totaled 123, and seventeen percent of all cash tender offers had a bidding premium[4] exceeding one hundred percent.[5] The list of distinguished firms that forfeited their independence led one English commentator to conclude "[f]easting on corporate assets, or defending oneself against being eaten by predators in turn, is seemingly a central preoccupation of U.S. management."[6]

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1. This is generally considered to be the fifth "peak" period of merger activity of the century. The first period (1899-1903) consolidated producers within key industries and was categorized as "merging for monopoly." The second period (1926-1929) has been called "merging for oligopoly." During the third period (1940-1949), many smaller firms sold out for estate tax considerations. The fourth phase (1955-1968) has been referred to as "merging for growth" and has resulted in the formation of conglomerates. *See generally Five Merger Movements*, MERGERS & ACQUISITIONS, Spring 1982, at 6.

2. *Merger Review*, MERGERS & ACQUISITIONS, Spring 1982, at 6.

3. Tender offers are public solicitations for shares of a "target" company, generally at a price above the current market value of the shareholder's stock. For a discussion of the mechanics of a tender offer and responses to it, see E. ARANOW, H. EINHORN & G. BERLSTEIN, DEVELOPMENTS IN TENDER OFFERS FOR CORPORATE CONTROL (1977); A. FLEISCHER, TENDER OFFERS: DEFENSES, RESPONSES AND PLANNING (1978).

4. A bidding premium occurs when shareholders receive a payment above the market value of their stock. Thus, if stock in Company *A* were selling for $10 per share and the tender offer were $20 per share, there would be a 100% bidding premium.

5. Austin & Boucher, *Tender Offer Update: 1982*, MERGERS & ACQUISITIONS, Fall 1982, at 48. The authors propose that the rise in tender offer premiums may be attributable to the fact that almost 50% of the tender offers that were contested failed during 1981. *Id.* at 49.

6. Thackray, *The American Takeover War*, MGMT. TODAY, Sept. 1982, at 82.

During 1982 and 1983 the pace slowed, but one epic confrontation occured in 1982 when William Agee, Chairman of Bendix Corporation, announced a $1.5 billion takeover bid for the Martin Marietta Corporation. Bendix successfully purchased a controlling interest in Martin Marietta, which in turn, with the aid of United Technologies Corporation, sought to acquire Bendix. Describing the consequences, Agee stated, "[t]o avoid a disastrous situation in which each company in effect owned the other, Bendix merged with the Allied Corporation."[7] The fierce battle rewarded shareholders of Bendix with eighty-five dollars a share for stock that was trading at approximately fifty-two dollars a share before the takeover attempt. In the process, however, Allied incurred $1.6 billion in debt, which raised its debt-to-capital ratio from twenty-two percent to forty-four percent.[8] Martin Marietta's price for freedom also left the company "certainly less well off than [they] were 33 days ago."[9]

When the action subsided, the takeover, and those who orchestrated it, was harshly criticized.[10] Hopefully, the epi-

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7. Agee, *Corporate Mergers' Value*, N.Y. Times, Oct. 19, 1982, at A31, col. 3.

8. *News Analysis: Russian Roulette, Executive Style*, INDUSTRY WK., Oct. 18, 1982, at 19, 20. A significant rise in this ratio greatly restricts the ability of the firm to borrow money in the future. A low ratio has historically been an indication of financial stability.

9. *Id.* at 20-21. Mr. Pownall, Chairman of Martin Marietta, understated the magnitude of the variance. Bendix's final offer was roughly equivalent to $55 per share for Marietta's stock, which was selling for less than $30 during most of 1982. The firm increased its long-term debt from $400 million to $1.3 billion and its debt-to-capital ratio rose from 22% to 44%. The present annual interest payment of approximately $120 million is over one-half of 1981 earnings. Its book value has fallen from $34 to $25 per share and Allied owns 39% of its stock. Moodys Investors Service responded by downgrading its commercial-paper rating for the firm from P-1 to non-prime and its senior unsecured debt from A1 to Baa3.

10. *See, e.g.*, Drucker, *Curbing Unfriendly Takeovers*, Wall St. J., Jan. 5, 1983, at 20, col. 4 ("The question is no longer whether unfriendly takeovers will be curbed but only when and how. The recent shoot-out between Bendix and Martin Marietta has deeply disturbed even the staunchest laissez-faire advocates in the business community."); Hayes, *Bendix et al., A Perspective from Harvard: The Undermining of Business Credibility*, N.Y. Times, Oct. 10, 1982, § 3 (Business), at 2, col. 3; Salmans, *Whither Mergers in the Wake of Bendix?*, N.Y. Times, Oct. 10, 1982, § 3 (Business), at 9, col. 1. Perhaps the most scathing criticism, supported by financial statistics, was that which asked, *Did Anyone Win the Bendix Game?*, BUS. WK., Oct. 11, 1982, at 28, and concluded, "what started as a Keystone comedy will be revealed for the 'corporate trag-

sode will have beneficial results.[11] It appeared to be a "win-win" situation[12] for those involved in the Bendix-Marietta battle. In particular, the executives of both companies were protected. This comment will discuss and analyze "golden parachute" contracts that shielded these executives from financial hardship.[13] It will consider the purpose of golden parachutes, analyze their impact and critique their results.

II. PREVALENCE AND CHARACTERISTICS OF GOLDEN PARACHUTES

Golden parachutes[14] are either modifications of existing employment contracts or separate employment agreements that provide for special payments, or a continuation of salary and benefits, to executives when their company is subject to a change of control.[15] Under traditional employment contracts, many executives were guaranteed a specified level of remuneration for their services both during and after em-

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edy' that close assessors say it is." *Id.* at 29; Rock, *Letter from the Publisher, Beyond Bendix: A Code of M & A Conduct*, MERGERS & ACQUISITIONS, Fall 1982, at 4.

11. Partially as a result of the Bendix affair the Securities and Exchange Commission established an Advisory Committee on Tender Offers which has issued its report. *SEC Advisory Committee on Tender Offers, Report of Recommendations*, (July 8, 1983), *reprinted in* FED. SEC. L. REP. (CCH) Special Report No. 1028 (July 15, 1983) [hereinafter cited as *SEC Advisory Report*].

12. In game theory a win-win situation exists when all the parties can benefit from the result. This is in contrast to situations in which any advantage to one party causes a corresponding loss to the other participant.

13. *See also* Klein, *Controversial Perk: A Golden Parachute Protects Executives, But Does it Hinder or Foster Takeovers?*, Wall St. J., Dec. 8, 1982, at 56, col. 1 ("Top executives of all four combatants in this year's fiercest takeover struggle— involving Bendix Corp., Martin Marietta Corp., Allied Corp. and United Technologies—all were wrapped in parachutes . . . ."). Law review articles and comments have begun to study the agreements. *See, e.g.*, Johnson, *Anti-Takeover Actions and Defenses: Business Judgment or Breach of Duty?*, 28 VILL. L. REV. 51, 69-71 (1982); Profusek, *Executive Employment Contracts in the Takeover Context*, 6 CORP. L. REV. 99 (1983); Riger, *On Golden Parachutes-Ripcords or Ripoffs? Some Comments on Special Termination Agreements*, 3 PACE L. REV. 15 (1982); Comment, *Future Executive Bailouts: Will Golden Parachutes Fill the American Business Skies?*, 14 TEX. TECH. L. REV. 615 (1983).

14. The term is borrowed from fairy tales and video games. It joins other innocuous terms such as sleeping beauty, white knight, prince charming, pac-man, shark repellant and poison pill.

15. The circumstances which trigger these agreements are critical and there are significant differences between contracts. *See infra* text accompanying notes 26-30.

ployment. However, there are major differences between golden parachutes and traditional employment contracts.[16]

A. Follow the Leader

Ward Howell International, an executive recruiting firm, has undertaken the definitive research into the use of golden parachutes.[17] After examining the proxy statements of 665 companies from the Fortune 500 and Second 500 lists, the study found that fifteen percent of the companies offered parachute provisions to top managers.[18] One executive consultant stated "that at least twenty-five to thirty percent of the major corporations have such agreements with one or more of their top executives."[19] But golden parachutes are not used at some larger companies because the companies' chief executives "are shy of receiving the sort of publicity that attended the rapid adoption of such plans during the Conoco and Bendix mergers."[20]

The agreements are offered typically to senior executives and key technical people.[21] The definition of "key" varies

16. R. Lambert & D. Larcker, "Golden Parachutes," Executive Decision-Making and Shareholder Wealth (1983) (unpublished manuscript) (available from authors at J.L. Kellogg Graduate School of Management, Northwestern University).

First, unlike most employment contracts, golden parachutes specify the remuneration which is paid to the manager after a change of control; second, unlike traditional employment contracts the manager can voluntarily leave the firm and obtain the agreed upon remuneration; third, golden parachutes are frequently given to executives who do not have existing employment agreements; fourth, employment contracts typically provide only a guaranteed salary, whereas golden parachutes commonly provide other executive benefits. *Id.* at 4-5.

17. Other consultants also have recognized a growing interest in parachutes among their clients. *See, e.g.*, Cooper, *Mergers and Acquisitions*, INSTITUTIONAL INVESTOR, Aug. 1982, at 65 (quoting Peat, Marwick, Mitchell & Co. principal Peter Chingos). Chingos also stated that of the ten largest takeovers in 1981, six of the acquired companies had golden parachute arrangements. *Id.* at 66.

Joseph Flom, merger and acquisition specialist with Skadden, Arps, Slate, Meagher & Flom, claimed that golden parachutes "are so common that a management that refuses them might very well risk losing the services of a number of key employees." Morrison, *Those Executive Bailout Deals*, FORTUNE, Dec. 13, 1982, at 82, 83.

18. *See* WARD HOWELL INTERNATIONAL, INC., SURVEY OF EMPLOYMENT CONTRACTS AND "GOLDEN PARACHUTES" AMONG THE FORTUNE 1000 (1982) (available from Ward Howell International, Inc., New York, New York).

19. *See* Meyer, *Executive Compensation Must Promote Long-Term Commitment*, PERSONNEL AD., May 1983, at 37, 40.

20. *Golden Parachutes in an Age of Fear*, CHEMICAL WK., Dec. 1, 1982, at 10.

21. Technical experts will frequently be protected in firms in which their expertise is the company's most valuable asset.

widely.[22] For instance, Professors Larcher and Lambert of The Kellogg Graduate School of Management at Northwestern University found that of those firms offering parachutes, an average of 9.7% of the executives were covered.[23] Furthermore, if the officers and directors are included, 26.1% are protected.[24] Therefore, a significant percentage of the senior-level managers who determine the firm's response to a potential takeover are covered by golden parachutes.[25]

B. Significant Terms

The terms of the golden parachute packages also vary, but the principle benefit — continuation of salary — is found in virtually all of them. Salaries are paid for periods of time ranging from twelve months to ten or more years. However, many payments expire at the end of the principal employment contract or when the executive is expected to retire.

Many of the parachutes open when the executive can establish that both a "change of control" and "termination" have occurred.[26] A significant number of contracts do not specifically define change in control. This may require judi-

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22. See Cooper, *supra* note 17, at 66-67, which provides information on the number of executives covered and answers the query, "How golden is your parachute?" The author presents data concerning: American Brands, American Can Co., AMF, Celanese Corp., Colt Industries, Conoco, Control Data Corp., Diamond Shamrock Corp., Kaiser Cement Corp., Kimberly-Clark Corp., Manville Corp., Phillips Petroleum Co., Superior Oil and United Technologies Corp.

23. R. Lambert & D. Larcker, *supra* note 16. This insightful study examined the changes in executive decision making and shareholder wealth associated with the adoption of golden parachutes. Using a preliminary sample of firms adopting golden parachutes, developed from discussions in published articles and surveys by several executive compensation and executive recruiting firms, a final sample of 90 firms was selected for empirical analysis. The study concluded that golden parachute disclosure is associated with a statistically significant positive price reaction and that golden parachutes used as antitakeover devices produced an adverse impact on shareholder wealth and provided "insurance" to the manager resulting in a favorable impact on shareholder wealth.

24. *Id.*

25. *Id.*

26. Since both events must occur before the executive may be compensated, it is referred to as a "double trigger." Other agreements require only a change of control and are referred to as "single trigger agreements." *See generally* McMillan & Reisinger, *Takeover Protection for Executives: The "Golden Parachute,"* COMPENSATION REV., First Quarter 1983, at 34.

cial construction of the particular clause.[27] A trigger definition or event is often provided, such as delisting on a stock exchange, a specific percentage change in company ownership (twenty percent ownership has frequently been used)[28] or a change in the composition of the majority of the board of directors.[29]

In addition, the termination clause is usually drafted broadly to allow the employee to resign for certain reasons. The employee may resign, for example, if the company attempts to fire him; changes the employee's responsibility, status, title or other "issues of pride"; or forces relocation. Some allow the executive to leave if, in good faith, he does not believe he can effectively carry out his responsibility.[30] Many of the plans eliminate the termination trigger totally and allow the executive to collect his compensation if he decides to leave for any reason. The major exceptions found in the termination clause are the employee's dismissal for cause because of fraud or embezzlement, or the employee's death.[31]

The compensation and benefits clause will frequently continue the executive's benefits, such as health insurance, life insurance[32] and pension contributions, as well as pay "any legal fees that may be incurred by an executive in exer-

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27. "Change of control" is generally defined in common law as the point at which existing management no longer has full control over the destiny of the company or their own jobs.

28. Executives of UNC Resources, formerly United Nuclear Corp., have parachutes that can operate when anyone acquires as little as 15% of the company. Morrison, *supra* note 17, at 85.

29. A particularly controversial parachute required the Mohasco Corp. to pay a total of $829,222 to four executives who left the company when Gulf & Western increased its holdings of Mohasco's stock to 22.5% exceeding the 20% control trigger. Mohasco explained that the executives "weren't terminated," and their leaving "was voluntary on their part." Each received cash equal to two years base salary plus an amount equal to the incentive compensation the officer received for the two years before a change in control. *Mohasco Must Pay a Total of $829,222 to Four Ex-Officers*, Wall St. J., Apr. 27, 1982, at 6, col. 3.

30. Morrison, *supra* note 17, at 85.

31. Profusek, *supra* note 13, at 107. Contracts that do not contain these exceptions would be subject to criticism for wasting corporate assets.

32. Thackray, *The Battle of Brunswick*, INSTITUTIONAL INVESTOR, June 1982, at 73, points out that Brunswick's board was not going to take any chances. "For good measure, they also paid up all future company and executive portions of management's life insurance packages . . . ." *Id.* at 74.

cising his severance option, which may include combatting being fired."[33] Many firms also provide for immediate vesting of contingent compensation, such as restricted stock and deferred contingent compensation.[34] Acceleration of exercise dates under stock option programs so that all stock options are exercisable immediately is extremely valuable due to the frequent increase in stock price during the tender offer. The ultimate benefit is the executive's option to receive the pay-out and then continue in his present job and receive his regular salary.[35]

III. Arguments Supporting Golden Parachutes

A. *Security and Competition for Talent*

The most persuasive argument supporting the use of golden parachutes is that they provide the executive with security in the event of a change of control. Executive recruiters often approach executives who are content with their present jobs. These executives will seek guarantees before accepting a new position, particularly if the firm or the industry is involved in merger speculation.[36] Reversing the situation, the agreements provide the necessary security so that the executive will remain with a company during a

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33. Cooper, *supra* note 17, at 68; *A Guard is Set Against Mergers*, CHEMICAL WK., Apr. 7, 1982, at 15.

34. McMillan & Reisinger, *supra* note 26, at 40.

35. Morrison, *supra* note 17, at 87 (describing the situation which is currently in litigation where the CEO of Burnup & Sims exercised a four million dollar parachute and has since returned as CEO). *See also Golden Rip-Offs*, INDUSTRY WK., July 25, 1983, at 46, 47; Klein, *supra* note 13, at 56.

36. William Smith of Pabst Brewing Company is an excellent example. He was president of Pittsburgh Brewery and, when he was approached by executive recruiters, Pabst was already deeply involved in takeover speculation and litigation with dissident stockholder Irwin Jacobs. It would be logical for an executive to seek assurances in this type of situation. *See generally* Reed, *Jacobs Hints Proxy Fight: Shake-'em-up Boss to Pabst*, ADVERTISING AGE, Sept. 21, 1981, at 2, col. 2. *See also World Business*, ECONOMIST, Apr. 16, 1983, at 78, 81 ("Mr. Sculley [new president of Apple Computer who resigned as president of Pepsi-Cola] says he looked before he leaped, though he would get a $1 million 'golden parachute' if he had to leave his new firm.").

An executive who is content in his present employment will only consider new employment if the compensation is increased. The former compensation package is thus the base which the new employer must start from to entice the executive to change jobs.

period of takeover rumors.[37] It has been argued that the agreements are a risk allocation method for which the executive would otherwise have to be financially compensated in salary or other inducements, and therefore, they should be considered as part of the total compensation package provided to the executive.[38] To properly assess this rationale, top management's importance to a firm must be considered. Executives' desire for security should be analyzed in light of current levels of compensation for executives.[39]

The importance of a chief executive officer (CEO) cannot be overemphasized. Most directors would agree that nominating and electing the CEO is a board of directors' most important function.[40] The constraints caused by mostly uncontrollable economic, social, legal, technological and political forces have made the task of managing a company more difficult than it was a decade ago.[41] For instance, proponents of the efficient market theory of stock prices will embrace the bittersweet sequel to the firing of Roy Ash as chief executive officer of AM International. "It was a humiliating exit . . . the stock market compounded the insult, as news of his departure led to a $4-per-share jump in AM International stock — boosting the value of his 300,000 shares by $1.2 million."[42] This example shows how important financial ex-

37. Metz, *Foiling Suitors to Forestall Takeovers, Many Concerns Move to Shore Up Defenses*, Wall St. J., Mar. 18, 1983, at 1, col. 6. *See also* Cabrera, *Takeovers. . . The risks of the game and how to get around them*, MGMT. REV., Nov./Dec. 1982, at 44.

38. Arguably, it is relatively cheap insurance. Since the executive wants to be compensated for the risk of job loss and resulting decline in future income, he would either want the security provided by the parachute or a higher level of present compensation. Since statistically the chances of a takeover are small, it is most likely cheaper for the firm to assume this risk. If, however, a firm wanted coverage, the event would be insurable by an insurance company.

It is also important to realize that the acquiring corporation may actually pay the executive's compensation. Under this reasoning the payout is a fixed liability that the acquiring firm assumes and includes as a transaction cost of the takeover. To the extent that the acquiring firm believes the net worth and expected value of the target corporation exceed its liabilities, it will proceed with the acquisition.

39. For an excellent treatment of top executive compensation see Vagts, *Challenges to Executive Compensation: For the Markets or the Courts?*, 8 J. CORP. L. 231 (1983) (considering the influences of the takeover mentality).

40. Every corporate charter bestows upon the board the duty to appoint the CEO. *See, e.g.*, WIS. STAT. § 180.41 (1981-82).

41. Mueller, *Foreward* to S. VANCE, CORPORATE LEADERSHIP xii (1983).

42. Nazem, *How Roy Ash Got Burned*, FORTUNE, Apr. 6, 1981, at 71.

perts view the leadership of a corporation, and how quickly the market responds to a change in top management.

The firing of a top executive is no longer the exception. Furthermore, numerous CEO's have left for "personal reasons" long before they wanted to retire. For example, two presidents resigned from Falstaff Brewery within nine months — the second resignation came less than two months after the president's installation; National Tea had three presidents in eight months; Kaiser Steel had eight presidents in seven years.[43] William Miller left the presidency of Canteen Corporation to become the president of Avis; however, he was soon replaced at his new job when Avis named its fifth president within three years.[44] Finally, the firing of Lee Iacocca as president of Ford Motor Company in a year in which the corporation made $1.8 billion[45] is evidence of the tenure that CEO's possess today.[46]

Explanations for the causes of the latest merger wave are numerous. Among them is the fact that inflation has altered the buy-versus-build equation in the quest for growth.[47] The consequences of inflation are also varied. Generally, because of inflation, static firms must reallocate assets to fast-growing businesses.[48] Consequently, depressed stock prices, which have pushed numerous firms significantly below book value, create tempting opportunities for raiders, speculators

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43. S. VANCE, CORPORATE LEADERSHIP 43 (1983).

44. *Avis Names Vittoria As President, Firm's Fifth in Three Years*, Wall St. J., Feb. 22, 1983, at 37, col. 1.

45. Marion, *CEO of the Year Award — Lee Iacocca of Chrysler*, FIN. WORLD, Mar. 31, 1983, at 22, 26.

46. Some management experts believe that the CEO should be a specialist in the functional area which the external environment dictates. This theory dismisses the view of the CEO as a generalist and categorizes him in a functional area based on education and past experience. Conceivably a board would therefore fire a "marketing" or "planning" CEO when difficult financial conditions in the economy dictate a "finance" or "numbers person."

47. Metz, *Mergers Expected to Stay Plentiful in 1983 But Will Be Less Exciting*, Wall St. J., Jan. 3, 1983, at 5, col. 1.

48. *News Analysis*, *supra* note 8, at 20. Sears is a prime example of a firm that is currently being rewarded by the market for forsaking retailing, with its cyclical swings and low margins, and vigorously positioning itself as a financial services corporation. The acquisitions of Allstate, Coldwell, Banker & Co. and Dean Witter all move them closer to their goal of becoming "the leading purveyor of consumer financial services." *The New Sears, Unable to Grow in Retailing, It Turns to Financial Services*, BUS. WK., Nov. 16, 1981, at 140.

or sharp CEO's intent on earning the maximum return for their shareholders.[49] Hired guns themselves contribute to the momentum.[50] Finally, the laissez-faire posture of the Reagan administration with regard to mergers provides what may be a brief opportunity for consolidation of companies.[51] While the cause of the recent increase in mergers is not certain, the result is predictable to the executive of an acquired company: an acquirer provides top management for the acquired company. Businessmen nervously tell the joke that an employee of a company involved in an acquisition gets the "mushroom treatment": first he is kept in the dark, then he is stewed for awhile and finally he is canned. One periodical warns executives: "At the outset, dispel the comforting illusion that only a few people are really frozen out in mergers."[52] A study by Lamalie Associates found top executives

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49. Ironically, less than ninety days before the Bendix offer one author stated:

> The corporate world, no less than the fashion world, is a place of trends and fads. William Agee, chairman of Bendix, mused publicly the other day about the joys of buying minority interests in other companies. You can get the 20%-size chunks at "wholesale," or market, prices and get out of your investment more easily than in full acquisitions. So, why go for a full acquisition where you may have to pay anywhere from 35% to 100%, or more, over market to clinch the deal?

Meyer, *Lawyer's Lament, Arbitrager's Delight*, FORBES, May 24, 1982, at 31. This "portfolio manager" strategy is based on the premise that a dollar invested in the other firm will bring the investing firm better returns than it could earn by investing in its own business.

50. "Hired guns" are keenly interested in takeover battles. Since they are compensated so substantially there is reason to "suggest" possible targets to a firm they know is capable of making an acquisition. The Bendix-Marietta war generated an estimated $40 million in fees for lawyers, investment bankers, public relations firms and solicitation firms. *See Money Well Spent: To Bankers and Lawyers It Was*, INDUSTRY WK., Oct. 18, 1982, at 20-21. *See also* Metz, *supra* note 37, at 1, col. 1; Editorials, *The Gilded Ripoff*, BUS. WK., Oct. 4, 1982, at 136.

51. *See* Blumstein, *Baxter Rejects Call to Curb Mergers*, N.Y. Times, June 3, 1983, § D (Business) at 1, col. 3, in which the author states:

> The takeovers, regardless of whether they are desired by the top executives of the companies being acquired, are a "very socially beneficial mechanism," said William F. Baxter, an Assistant Attorney General. His antitrust division investigates proposed mergers and other corporate activities to determine whether they might reduce competition in violation of antitrust laws.
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> Takeovers are part of "a mechanism that enables corporate assets to be shifted from lower- to higher-value uses" and are "one of the most important functions that our capital markets perform," Mr. Baxter said.

52. *Holding On In a Takeover*, BUS. WK., Sept. 27, 1982, at 118. The article reports that a "new survey by 'outplacement' consultants Drake, Bean & Morin Inc. shows that of 1300 executives — with incomes of between $30,000 and $125,000 —

to be in the greatest peril. After studying 260 senior executives involved in recent major takeovers, fifty-two percent of the acquired executives had departed within three years.[53] However, these statistics are misleading since in the acquisition of people-intensive, high technology companies, the major asset may be the entrepreneur or brilliant chemist who, with the aid of a golden parachute, is free to voluntarily terminate his employment, often to the detriment of the new owner.[54] That scenario occurred when the executives of Thiokol Corporation "defected" after Morton-Norwich acquired the firm. President Robert Davis pulled the ripcord on his four million dollar golden parachute because apparently "it stuck his craw not to be CEO" and he hoped for an "equal partnership" but did not get it.[55] Other executives with parachutes followed Davis out because they were nearing retirement, simply didn't want to move to Chicago, and felt uncomfortable working for Morton. "These departures don't bode well in a business (defense contracting) where personal contacts count and where Morton has none."[56]

Financial incentives offered to top management are noteworthy to the media, and for almost thirty years, magazines have published scorecards disclosing "who gets paid what."[57] Boards of directors[58] have also demanded informa-

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who were 'severed' in the 18 months ending August 31, a disquieting 32% were let go during mergers, takeovers, and the like." *Id. See also* Nossiter, *Oh, Those Golden Parachutes: They're a Great Comfort to More and More Executives*, BARRONS, Nov. 29, 1982, at 15, col. 1 ("And history has shown that there are few species more endangered than top management who fought the good battle and lost.").

53. Coff, *Merger Mania Adds to Executives Woes*, N.Y. Times, Oct. 17, 1982, § 12, at 10.

54. Moon, *Tender Offers: How to Win*, FIN. EXECUTIVE, Aug. 1983, at 30. *See also* B. FOX & E. FOX, CORPORATE ACQUISITIONS AND MERGERS, § 27.07 [1] (1982) ("If the skills, knowledge and experience of top management or key officials are important to the successful operations of the target company, and if those persons are planning or likely to resign in the event of a takeover, these facts might be made clear to any offering company.").

55. Dorfman, *The Thiokol Defections*, FORBES, Mar. 28, 1983, at 110.

56. *Id.* The question of whether key, creative people stay when "protected" was also answered negatively when white knight United Technologies acquired Mostek Corporation. "After the Acquisition by UT, one by one, five of the six people in Mostek top management left." Lipton, *High Technology Acquisitions*, MERGERS & ACQUISITIONS, Fall 1982, at 34, 38.

57. *Business Week* has been providing this information since at least 1950. *See, e.g.*, *Top Drawer Pay*, BUS. WK., May 20, 1950, at 35. It has been joined by numerous other publications including *Duns Review*, *Forbes* and *U.S. News & World Report*.

tion on compensation levels[59] for comparison purposes. In fact, commentators have noted the seriousness which characterizes the approach of boards to this important decision.[60]

Publicly-held firms must provide information to the Securities and Exchange Commission (SEC) and also must disclose on proxy statements data concerning remuneration paid to the firm's five highest paid officers.[61] Publication of this information provokes the perennial criticism that boards

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Patton, *Why So Many Chief Executives Make Too Much*, BUS. WK., Oct. 17, 1983, at 24, argued:

> Publication of the original executive pay survey in 1951 undermined the strong company loyalty that had existed prior to the war.
>
> Intense self interest began to dominate the actions of more and more executives. With compensation surveys to tell them what their job might be worth and headhunters offering premiums of 50% or more, it became more attractive — and lucrative — for executives to change jobs . . . .

58. The board of directors is charged by its charter and bylaws with the duty of setting the compensation of the top executives. Boards may relegate this task to a compensation committee. WIS. STAT. § 180.31 (1981-82).

59. Within the last twenty years numerous firms have been established to satisfy the information requests of boards. These specialists analyze the total compensation package and provide information concerning compensation paid to executives in comparable positions. Major firms gathering this information include Hay Group Associates; Towers, Perrin, Forster and Crosby; and McKinsey & Co.

60. *See, e.g.*, Loomis, *The Madness of Executive Compensation*, FORTUNE, July 12, 1982, at 42.

> Compensation committees spend enormous amounts of time checking what peer companies pay, so that the committees can satisfy themselves they are not getting grossly out of line. "Directors," says consultant Peter T. Chingos of Peat Marwick Mitchell, "are almost paranoid on this subject. They know there have been a few suits that have attacked the directors for paying too much" — some have befallen Norton Simon and International Harvester — "and they know the press likes to write about who's getting the most money. No director wants to be the one paying the most."

Id. at 45. *See also* Meyer, *supra* note 19, at 38, in which the author states:

> Skepticism of both executive performance and executive pay is growing in the boardroom, where compensation committees have emerged as real power centers in corporate governance. This derives from their role in setting goals and in assessing corporate and executive performance. Executive compensation has emerged in the 1980's as a major tool of the board in directing and controlling corporate activity.

61. Currently, disclosure of the remuneration of the five most highly compensated executive officers must be provided if it exceeds $60,000. The SEC has recently amended Item 402 of Regulation S-K [17 C.F.R §§ 229.402 & 240.14a-101], 48 Fed. Reg. 44,473 (1983). The rules reduce the amount of information that companies must disclose. *See* Hudson, *SEC Proposes Reducing Data That Firms Must Report on Executives' Compensation*, Wall St. J., Jan. 14, 1983, at 5, col. 2. The new rules have already invoked criticism. *See Concealing the Boss's Pay*, N.Y. Times, Feb. 14, 1983, § A, at 16, col. 1.

are lax in discharging their responsibilities to their shareholders.[62]

The success of most businesses depends in large part on their ability to attract and keep good executives.[63] Competition among corporations for the best people is keen and sets the level of executive compensation.[64] One study profiled

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62. In perhaps the most significant article on the subject, one author stated:

> In the upper reaches of corporate America, the market frequently does not seem to work. In a totally rational world, top executives would get paid handsomely for first-class performance and would lose out when they flopped. But to an extraordinary extent, those who flop still get paid handsomely.
>
> . . . . [S]o many examples of near-unarguable excess exist that a lot of directors must be thought guilty of falling down on the job, perhaps in part because they are often themselves corporate executives and therefore beneficiaries of the system.
>
> . . . . [I]t is widely believed that many compensation committees are rubber stamps, unwilling to be hard-nosed about the pay of top executives, particularly those chaps who are fellow members of the board.

Loomis, *supra* note 60, at 42-45. *See also Is any CEO Worth $1 Million a Year?*, DIRECTORS & BOARDS, Winter 1982, at 26.

Nossiter, *supra* note 52, at 15, quotes Everett Keech, vice dean of the Wharton School, for the proposition that the "proliferation of the pacts [golden parachutes] raises the question — perhaps rhetorically — of how independent supposedly independent directors really are?"

63. *See* Meyer, *supra* note 19, at 37, in which the author stated:

> Recent studies that matched companies in the same industries facing the same stresses, the same business conditions and the same challenges, found that the quality of management and its decisions spelled the difference between success and failure.
>
> . . . . [A]t the heart of corporate performance and productivity in America, then, is the retention and the consistent motivation of high-quality management.

See also Freedman v. Barrow, 427 F. Supp. 1129 (S.D.N.Y. 1976), which involved a shareholder challenge to Exxon's incentive program. The court was cognizant of the needs of corporations to retain and reward executives. "Keeping the high level of motivation of these employees, retaining their loyalty in the future, and protecting their skills, experience and specialized knowledge from raids by competitors or others is the biggest single responsibility of top management, which naturally is also interested in its own compensation." *Id.* at 1136.

64. Petitpas, *Good Pay Plans Can Support Strategy*, INDUSTRY WK., Jan. 24, 1983, at 13. The author, director of Cresap, McCormick and Paget, Inc., stated that "executive compensation is essentially determined by the market — that is, by what others are paying to people who are working at given levels of responsibility and performance." A strong argument can be made that the market for executive talent has few significant entry barriers and there is a substantial pool of talent to draw from. The relatively high level of turnover would support the competitive nature of this market. Since it is competitive, salaries also would be responsive because there would be no reason for a firm to bid more than necessary for services. *See also* Fama, *Agency Problems and the Theory of the Firm*, 88 J. POL. ECON. 288 (1980); Shavell,

the typical CEO,[65] but more importantly, documented his contribution to shareholders and society.[66] Few would quarrel with compensation exceeding one million dollars for Lee Iacocca.[67] However, the decisions of boards of directors, who are now sanctioning ratios of CEO salaries to workers' median wages of 50 to 1 and even up to 150 to 1 (while in Japan comparable ratios are closer to 15 to 1), raises serious questions.[68] It has been suggested by prominent business school professors that their new graduates are putting their own interests ahead of the firms which hire them.[69] Board members struggle with difficult realities each time they deal with policies, personalities and performance in deciding

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Risk Sharing and Incentives in the Principal and Agent Relationship, 10 BELL J. ECON. 55 (1979); Vagts, *supra* note 39.

65. The study found the typical CEO is 60 years old; earned his top position at age 55; averages between 55 and 64 hours a week on the job; takes three weeks vacation a year; and has attended graduate school. Burch, *A Group Profile on the Fortune 500 Chief Executive*, FORTUNE, May 1976, at 172.

66. The typical Fortune 500 company corporate executive directs a company whose sales in 1975 averaged almost $1.75 billion, whose assets totaled $1.33 billion and which provided employment for almost 29,000 people. The average return on its total investment was 11.6%. *Id.*

67. *CEO of the Year Awards*, FIN. WORLD, Mar. 31, 1983, at 17, described his achievement as follows:

> Five years later, against incredibly long odds, Iacocca has done just that — he's saved Chrysler. In one of the most stirring performances in business history, he has returned the company to full year profitability in the midst of a deep recession and erased all doubts about its survival. Certainly there are no doubts about his performance among the judges for Financial World's CEO of the Year awards. Recognizing his stupendous achievement, they have named Chairman Lee A. Iacocca of Chrysler as this year's gold award winner.

But see Patton, *supra* note 57, at 26:

> The top executives of a large number of the 100 largest companies, however, are administrators, not entrepreneurs. They head organizations that were already in being when they reached the top. They are selling products or services developed by others and usually remain in the top job for a very short time. Yet directors frequently pay them as though they were entrepreneurs.

68. S. VANCE, *supra* note 43, at 80.

69. Friedman & Solman, *Is American Management Too Selfish?*, FORBES, Jan. 17, 1983, at 75. "What we fail to instill in our students," says Robert Glauber [Professor of Finance at Harvard], "is that they're agents of the system, not principals. That they are being hired. But they don't look at it that way. For many of them, it's the managerial class against the world, willing to steal from the rich and poor alike." The article concludes, "[a]ll the professors agree that we've got a problem: American managers are too selfish and unaccountable." *Id.* at 77.

what executives should be paid and whether golden parachutes should be part of the arrangement.[70]

B. Defensive Tactic

Some proponents of golden parachutes also argue that they are a defense against takeovers. However, the SEC Advisory Committee concluded that "[i]n general, the Committee does not believe the arrangements for change of control compensation in fact deter takeovers, as they are a small fraction of an acquisition price."[71] The Committee may be correct in a takeover involving a large firm, but in an acquisition of a smaller company, the transaction cost may be much more significant.[72] A recent federal district court case, *Allen v. Gulf Resources & Chemical Corp.*,[73] involved a lawsuit brought by dissident stockholders who won control of the company in a proxy dispute. The shareholders refused to pay a thirteen million dollar parachute package. The firm reported a $77.9 million loss for 1981.[74]

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70. Patton, *supra* note 57, believes there are inherent problems with compensation committees:

> Compensation committee members are usually chosen by the CEO. Needless to say, such appointees are on friendly terms with the CEO. Not infrequently, each is on the other's board of directors.
>
> In judging management performance, these committee members share one or more disadvantages:
>
> —They have little day-to-day knowledge of individual performance.
>
> —Most come from a different industry; therefore their understanding of the economic pressure points that can determine the company's profit or loss is usually limited.
>
> —The professional or banking firms in which many directors are partners frequently serve the company, creating at least a potential conflict of interest.
>
> Retired executives like to be reelected each year to company boards, for the rewards are not insignificant. Directors with a reputation for constantly challenging the chief executive are less apt to be asked to return.

Id. at 24-26.

71. *SEC Advisory Report*, *supra* note 11, at 39-40.

72. See *supra* note 38 for a discussion of golden parachutes as a transaction cost.

73. No. 82-27756 (D. Ct. Harris County, Tex.) (compromise settlement agreement in favor of Gulf Resources & Chemical Corporation was reached on January 19, 1984).

74. *Author of Gulf's Success Written Out of the Part*, N.Y. Times, June 10, 1982, § D, at 2, col. 5.

C. Objective Decision Making

Undoubtedly one of the most controversial "benefits" of parachutes is that they will result in managers making more objective decisions. Management literature,[75] executive speeches[76] and court decisions[77] have uniformly agreed that the shareholder interests should be paramount in corporate decision making. However, commentators have alluded to the potential differences in duties owed to arbitragers who, due to leveraging, may have an extremely short-term view of the future.[78] Numerous critics of parachutes correctly argue that executives are already being compensated to make objective decisions in the interest of the corporation and therefore, any additional payment lacks consideration and is a waste of corporate assets.[79] This argument has been advanced in a number of recent court challenges to parachutes.[80] It also seems unlikely that an executive would "jump ship" at a time of crisis. Since his future employment is heavily dependent on past performance, any indication of a lack of loyalty or unwillingness to act with the best inter-

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75. *See* S. VANCE, *supra* note 43, at 264-65. Corporations have stakeholders who consist of shareholders, executives and other employees, customers, suppliers and the general public. "But the most significant corporate constituency is the body of shareowners." *Id.*

76. For example, William Agee is quoted as saying, "[y]ou've got to begin with the basic tenet that the job of management is to maximize shareholder value." Koten, *Bill Agee of Bendix Corp.: Why I Did It*, Wall St. J., Oct. 4, 1982, at 32, col. 2. He also wrote his own explanation of the episode and made the following observation:

> But our original initiative and the final result were totally consistent with both the history of corporate growth and with the foremost objective of responsible management: improving the value of the shareholder's investment over the long term. . . . Corporate leaders should not confuse the shareholders' best interest with their own. Scorching the earth, and tiers of tender offers, may help corporate leaders preserve their jobs, but they do not benefit shareholders as a whole, or the economy.

Agee, *supra* note 7, at A31.

77. *See, e.g.*, Panter v. Marshall Field & Co., 646 F.2d 271, 298-99 (7th Cir.), *cert. denied*, 454 U.S. 1092 (1981); Treadway Co. v. Care Corp., 638 F.2d 357, 381 (2d Cir. 1980).

78. *See, e.g.*, Lipton, *Takeover Bids in the Target Boardroom*, 35 BUS. LAW. 101, 104 (1979). *But see* Easterbrook & Fischel, *The Proper Role of Target's Management in Responding to a Tender Offer*, 94 HARV. L. REV. 1161, 1183-85, 1183 n.60 (1981).

79. Cooper, *supra* note 17, at 68 ("giving people a bonus to do what they should do anyway."); Morrison, *supra* note 17, at 83; Nossiter, *supra* note 52, at 15.

80. *See generally Golden Rip-Offs*, *supra* note 35, at 47-48 (discussing recent shareholder suits).

ests of stockholders in mind would seriously affect his future career.

Proponents argue that golden parachutes reduce distraction[81] and promote an environment in which the executive is able to make decisions without bias since his financial security will not be affected.[82] But it should also be noted that factors other than monetary compensation may influence an executive's action at this stage. These factors include the desire to protect the job for the status that it brings,[83] and, because a takeover is seen as an indication of below average executive performance,[84] the unwillingness to allow one to occur.

D. Lack of Consensus as to Benefits

As stated above, closely related to the benefit of objective decision making is the argument that golden parachutes strengthen a company's resistance to a takeover. However, stated in this form, the argument is clearly fallacious because each offer is unique and requires an objective determination by management and the board.[85] Numerous commentators

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81. *See, e.g.*, *Phillips Petroleum to Give Top 6 Officers 3 Years' Pay If Takeover Ends Their Jobs*, Wall St. J., Mar. 31, 1982, at 8. The distraction argument is premised on the fact that during a takeover fight the executive is under extreme pressure. If the decision is made to resist the offer, specialists advise a rapid, firm response on a number of fronts. The argument continues that due to time demands any distraction has negative effects and should be eliminated if possible.

82. Unfortunately even "indifference" has its problems because an executive who feels totally protected may lack the motivation to properly analyze the transaction since his self interest is removed. For instance, many CEO compensation plans are structured with options and bonuses under which the price of the firm's stock directly influences the executive's wealth, thus creating a "win-win" maximization for the executive and shareholders. *See, e.g.*, *Executives Keep Reducing the Risks of a High-Reward Career*, BUS. WK., May 9, 1983, at 83.

83. Petitpas, *supra* note 64, at 13; Koten, *supra* note 76, at 32 ("A former Bendix director was quoted in this newspaper as saying . . . 'It's a struggle between a few very ambitious men using public companies for their own gain.' "). *See also* McLaughlin, *The Myth of the Golden Parachute*, MERGERS & ACQUISITIONS, Summer 1982, at 47, 48.

84. The ego factor should not be underestimated. Critics have cited this as being very evident in the Bendix affair. *See* Morrison, *supra* note 17, at 86.

85. In reality it requires two decisions: the correct valuation of the firm and then an analysis of the value of the offer. The creativity of offer provisions and the complexity of valuation are often cited as reasons requiring the board's expertise. It also could be harmful competitively for the corporation to divulge too much information to shareholders, yet without information such as the probability of a new patent's

have recently written on the duties of target management responding to takeover attempts, and many of them have concluded that there is a fundamental dichotomy between the interests of management and shareholders.[86] Much of the disagreement is undoubtedly caused by a lack of consensus as to whether the takeover process itself is beneficial or socially desirable.[87] Those who favor takeovers seem to be in the majority and they argue that acquisitions are a method of disciplining the market by punishing inefficiency and promoting a proper allocation of resources.[88] Commentators and courts opposed to mergers point out that often the decisions are made under time pressure without adequate information.[89] They argue that the vast sums which are paid to attorneys and the extreme profits generated by arbitragers may be at the expense of traditional shareholders and other

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success or market share data the decision is being made without proper input. However, with respect to the decision to sell a firm, the adage, "everything has a price," seems to be valid.

86. *See, e.g.*, Easterbrook & Fischel, *supra* note 78; Gelfond & Sebastin, *Reevaluating the Duties of Target Management in the Hostile Tender Offer*, 60 B.U. L. REV. 403 (1980); Gilson, *A Structural Approach to Corporations: The Case Against Defensive Tactics in Tender Offers*, 33 STAN. L. REV. 819 (1981); Johnson, *Anti-Takeover Actions and Defenses: Business Judgment or Breach of Duty?*, 28 VILL. L. REV. 51 (1982); Lowenstein, *Pruning Deadwood in Hostile Takeovers: A Proposal for Legislation*, 83 COLUM. L. REV. 249 (1983); *Contra* Block & Miller, *The Responsibilities and Obligations of Corporate Directors in Takeover Contests*, 11 SEC. REG. L.J. 44 (1983); Lipton, *Takeover Bids in the Target's Boardroom: An Update After One Year*, 36 BUS. LAW. 1017 (1981); Lipton, *Takeover Bids in the Target's Boardroom*, 35 BUS. LAW. 101 (1979); Lipton, *Takeover Bids in the Target's Boardroom: A Response to Professors Easterbrook and Fischel*, 55 N.Y.U. L. REV. 1231 (1980).

87. *See, e.g.*, Kiechel, *Don't Stop the Mating Game*, FORTUNE, Aug. 24, 1981, at 70; Louis, *The Bottom Line on Ten Big Mergers*, FORTUNE, May 3, 1982, at 84; Lubatkin, *Mergers and the Performance of the Acquiring Firm*, 8 ACAD. MGMT. REV. 218 (1983); *After Recent Merger Wave, Analysts are Debating Pluses*, N.Y. Times, May 31, 1982, § D, at 1, col. 7. Perhaps the most significant harm of the takeover paranoia is the adverse effect on long-term planning. The expenditure of executive time on tactics designed to monitor or eventually defeat takeovers is harmful, but more critical are the potential business decisions. The possibility that management would spend liquid reserves earlier than planned so as to be less attractive is certainly a short-term strategy. Drucker, *supra* note 10, at 20.

88. *See SEC Advisory Report*, *supra* note 11, at 7-14.

89. The willingness of an acquiring firm to bid is arguably evidence of its belief that the stock is undervalued relative to its assets or future earnings potential. Many criticize the recent takeover phase as an attempt to surprise management and shareholders of the target and force a decision before a proper valuation can be made. Forcing the decision on an accelerated time basis does not allow time for a search for potential white knights either.

stakeholders of the acquired firm.[90]

IV. Judicial Decisions

Rule 14e-2[91] is important when considering the duty of target management to a tender offer. The rule requires management to take a position regarding any tender offer within ten days of commencement of the offer. A statement explaining management's reason for the position must be disclosed.[92] Management may have an affirmative duty[93] to oppose a tender offer which, in its judgment, is contrary to the best interests of the corporation and its shareholders.

The decisions of management have been supported by courts under the business judgment rule. It has been articulated in many different ways, but is grounded in the belief that businessmen are most competent to make business decisions and therefore the courts should not interfere. The Seventh Circuit Court of Appeals decision of *Panter v. Marshall Field & Co.*[94] contains a representative statement of the Rule

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90. *See supra* notes 75 & 78. *See also* Abegglen, *Can Japanese Companies Be Acquired?*, Mergers & Acquisitions, Winter 1983, at 16, 18. ("[U]ltimately the Japanese company exists for the employees, to ensure their well-being and their future. Thus, sale of the company is not a decision for the shareholders but is rather a decision for the entire workforce of the company."). Vagts, *supra* note 39, at 241 stated, "concentration upon improving the earnings performance of a firm during a given year may not be in harmony with the interests of the shareholders in maximizing the value of their securities, a value that depends upon the stream of earnings expected to be derived over a number of years." *See also* Herald Co. v. Seawell, 472 F.2d 1081 (10th Cir. 1972).

91. 17 C.F.R. § 240.14e-2 (1983). Securities and Exchange Commission Rule 14e-2 requires the target to announce its position with respect to the tender offer. *See generally* Johnson, *Disclosure in Tender Offer Transactions: The Dice are Still Loaded*, 42 U. Pitt. L. Rev. 1 (1980).

92. See B. Fox & E. Fox, *supra* note 54, at § 27.06[2] for a discussion of the disclosure schedules.

93. *See, e.g.*, Northwest Indus. v. B.F. Goodrich Co., 301 F. Supp. 706 (N.D. Ill. 1969). The court recognized that officers and directors would frequently be accused of trying to preserve their jobs at the expense of the corporation, but held "management has the responsibility to oppose offers which, in its best judgment, are detrimental to the company or its stockholders." *Id.* at 712.

94. 646 F.2d 271 (7th Cir.), *cert. denied*, 454 U.S. 1092 (1981). The court stated:

> Directors of corporations discharge their fiduciary duties when in good faith they exercise business judgment in making decisions regarding the corporation. When they act in good faith, they enjoy a presumption of sound business judgment, reposed in them as directors, which courts will not disturb if any rational business purpose can be attributed to their decisions. In the absence

and is also important for the warning expressed by a dissenting judge, who stated that serious consequences can flow from a total abdication by courts in these decisions.[95] Courts have allowed to stand actions of directors and management which evidence the *desire* to remain in control, unless there exists a "sufficient showing that the *primary* motive of the board of directors was to retain control."[96]

A number of courts, however, have been willing to limit the use of the business judgment rule in takeover situations. In *Donovan v. Bierwirth*[97] the Court of Appeals for the Second Circuit affirmed a preliminary injunction, agreeing that directors of the Gruman Corporation, who were also trustees of the employee's pension plan, violated their fiduciary duties under the Employee Retirement Income Security Act of 1974 (ERISA)[98] by using pension plan assets to purchase Gruman stock on the open market during a takeover attempt. It is possible that a court would apply the same duty to directors confronted with a contractual golden parachute.

> of fraud, bad faith, gross overreaching, or abuse of discretion, courts will not interfere with the exercise of business judgment by corporate directors.

Id. at 293 (quoting the trial court, Panter v. Marshall Field & Co., 486 F. Supp. 1168, 1194 (N.D. Ill. 1980)) (citations omitted).

95. 646 F.2d at 299 (Cudahy, J., dissenting) ("I emphatically disagree that the business judgment rule should clothe directors, battling blindly to fend off a threat to their control with an almost irrebuttable presumption of sound business judgment . . . .").

96. Johnson v. Trueblood, 629 F.2d 287, 293 (3d Cir. 1980), *cert. denied*, 450 U.S. 999 (1981) (emphasis added). See also Whittaker Corp. v. Edgar, 535 F. Supp. 933 (N.D. Ill. 1982) in which the court stated: "Whittaker has not made a sufficient showing that the primary motive of the board of directors was to retain control." *Id.* at 951. *But see* Joseph E. Seagram & Sons, Inc. v. Abrams, 510 F. Supp. 860 (S.D.N.Y. 1981). There the court found sufficient evidence to issue a temporary restraining order to prevent directors from taking actions, including a "scorched earth" policy that would undermine shareholder autonomy in tender offer disputes.

> The events pose a possible case of a determination to keep control of the company entrenched within the present board of directors regardless of the company's real best interests or else to dismember it piece by piece, even to the point of liquidation of the enterprise, regardless of the proclaimed profitability and in the absence of all evidence whatsoever that the actual owners of the enterprise want its demise.

Id. at 862.

97. 680 F.2d 263, 271 (2d Cir. 1982).

98. 29 U.S.C. §§ 1001-1381 (1976 & Supp. V 1981). *See generally* Grinstead, *The Treatment of Employee Benefit Plans in Acquisitions*, THIRTEENTH ANN. INST. ON SEC. REG. 95 (1982).

However, ERISA has placed extraordinary requirements on trustees in order to safeguard workers' pensions.

The judicial policies of standing and mootness have resulted in a number of courts refusing to consider the merits of golden parachutes. In *Lewis v. Anderson*[99] the Delaware Chancery Court dismissed a lawsuit because the plaintiff lacked standing after completion of the merger. In *Mills v. Esmark*[100] mootness was the cause for dismissal. The Second Circuit recently declined to adopt a broad interpretation of the Williams Act.[101] The court reversed the district court and held that the gravamen of the claim was a breach of management's fiduciary duty to shareholders which is a matter traditionally committed to state law.[102] The court also held that employment guarantees had been adequately disclosed through reference to the earlier merger agreement and thus Rule 14e-2 was not violated.[103]

V. SEC Advisory Committee on Tender Offers

At this point it is unclear what effect the SEC Advisory Committee on Tender Offers[104] report will have on the SEC, Congress or the courts. The composition of the Committee was severely criticized and even after the addition of two members it was still dominated by merger and acquisition professionals.[105] Many consider the recommendations to be

99. 453 A.2d 474 (Del. Ch. 1982) (dissident Conoco shareholder challenged the validity of a $10 million golden parachute agreement given to nine executives prior to the DuPont takeover; the court reasoned that since DuPont knew of the contracts before the takeover, they assumed the employment agreements).

100. 544 F. Supp. 1275 (N.D. Ill. 1982) (court found no waste of corporate assets).

101. 15 U.S.C. §§ 78g, 78*l*-78n, 78s (1976). The Williams Act regulates the conditions under which a tender offer can be made. A major effect of the Act is to create sufficient delay to give the target's management the time to formulate a defensive strategy. Ideally shareholders will then have sufficient information to make an informed decision regarding the sale of their stock. See B. Fox & E. Fox, *supra* note 54, at § 27.04[3] for a discussion of the requirements of the Williams Act.

102. Data Probe Acquisition Corp. v. Datatab, Inc., 722 F.2d 1 (2d Cir. 1983).

103. *Id.*

104. *SEC Advisory Report*, *supra* note 11.

105. *See, e.g.*, Gilpin, *Takeover Reform A Tender Topic*, N.Y. Times, Apr. 18, 1983, at 22, col. 3; Icahn, *A Statement to American Management: Stop the Oppression of Shareholders*, N.Y. Times, May 22, 1983, § 3, at 2, col. 2 ("tantamount to the Environmental Protection Agency appointing a panel of captains and owners of the Japanese fishing fleet to study the preservation of the whale."); Editorials, *Takeovers and the Public Interest*, Bus. Wk., June 13, 1983, at 152.

merely fine tuning and the Committee has been criticized for not adequately discouraging takeover proposals.[106]

Most significantly the Committee recommended retention of the business judgment rule as the standard for testing the actions of management.[107] However, the Committee has proposed that an annual nonbinding shareholder vote be conducted as to whether defensive tactics such as "supermajority"[108] charter provisions and golden parachutes should be employed. The effectiveness of this proposal as a protection for the majority of investors is questionable. While institutional investors have shown a willingness to vote against management on issues involving defensive tactics,[109] it is likely that the majority of shareholders would follow management's recommendations on golden parachutes and approve defensive proposals by wide margins. Evidence of this is found in the consistent shareholder support of other proxy issues.[110]

The Committee also recommended that the granting of golden parachutes be prohibited during merger battles.[111] Apparently, it was felt that there was an increased likelihood of abuse, since decisions would be made without proper consideration and the appearance of self-dealing is more acute. This recommendation may be hard to enforce since it would be difficult to define at what point a tender offer is imminent. It is also hard to understand how the agreements "present

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106. Brownstein, *Merger Wars—Congress, SEC Take Aim At Hostile Corporate Takeover Moves*, NAT'L J., July 23, 1983, at 1538, 1539-40; *Changing the Rules on Tenders: A Report That Treads Softly*, BUS. WK., June 13, 1983, at 33 ("In this particular chicken coop, the foxes seem rather numerous: the committee is filled with investment bankers and lawyers who specialize in launching or defending against unfriendly takeovers."); Editorial, *Taking Over Takeovers*, ECONOMIST, July 9, 1983, at 13.

107. *SEC Advisory Report*, *supra* note 11, at 34.

108. A supermajority provision is a bylaw term that erects a high barrier to change in control by requiring a large level of approval from the shareholders.

109. *See Why Anti-Takeover Barriers May Not Work*, CHEMICAL WK., Aug. 3, 1983, at 35, 39; Okamoto, *Stockholders Go On the Attack*, BUS. WK., June 13, 1983, at 32; Lewin, *Business and the Law: Proxy Fights Proliferating*, N.Y. Times, Apr. 19, 1983, at 30, col. 1; Blustein, *Measures to Discourage Takeovers Stir Controversy at Annual Meetings*, Wall St. J., Apr. 18, 1983, at 29, col. 3.

110. *See, e.g.*, Loomis, *supra* note 60, at 46 ("It is hard to imagine uprising by stockholders, who are seldom driven to vote down management proposals of any kind . . . .").

111. *SEC Advisory Report*, *supra* note 11, at 40.

the appearance of self-dealing" during a takeover situation, and yet not six months earlier. Basically, the recommendation appears to be an attempt to appease the critics of the practice by prohibiting it.

VI. Recommendations

The decision of whether to allow golden parachutes is not easy. It is a policy decision that entails many factors and, at present, it is particularly difficult to formulate regulations since so few parachutes have been exercised. A major problem is that parachutes influence an executive psychologically, which makes it almost impossible to predict how each executive will react. If, as William Agee claimed, he would not have done anything differently without the golden parachute protection,[112] the issue of what benefit they actually provide to the corporation is more acute. While it is understandable that courts do not wish to make these types of decisions, the business judgment rule should not be used to bar all inquiries into the decisions of a corporation. The serious reservations expressed by many prominent executives and business publications should compel a court to ascertain whether the contracts have been entered into after proper consideration of all the implications.[113] If the courts continue to allow shareholder challenges to board action through the use of derivative suits[114] and proxy challenges,[115]

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112. Morrison, *supra* note 17, at 84.

113. *See* Cooper, *supra* note 17, at 68; Editorials, *supra* note 50, in which the author stated that parachutes are an "outrageous misuse of stockholders' assets and an abuse of management prerogatives. They encourage the public's distrust of business. And they stiffen worker resistance to wage and benefit concessions that many companies need to stay in business." *Id.* at 136. *See also Golden Rip-Offs*, *supra* note 35, at 46-48.

114. *See generally* 2 R. MAGNUSON, SHAREHOLDER LITIGATION § 15 (1981); Block & Prussin, *The Business Judgment Rule and Shareholder Derivative Actions: Viva Zapata?*, 37 BUS. LAW. 27 (1981); Dent, *The Power of Directors to Terminate Shareholder Litigation: The Death of the Derivative Suit?*, 75 NW. U.L. REV. 96 (1980); Schwartz, *Shareholder Democracy: A Reality or Chimera*, CALIF. MGMT. REV., Spring 1983, at 53, 64.

115. Lewin, *supra* note 109, at 30. After explaining the increasing willingness to challenge management's decisions, the author discussed a recent proxy contest: "One sidelight to the Louisiana Land battle is the dissident slate's promise that, if elected, it will not grant any further 'golden parachutes,' or termination agreements, to executives without shareholder ratification." *Id.*

the board of directors should continue to make the decision involving golden parachutes. Adequate disclosure of the agreements is a necessity if these checks are going to effectively operate. Boards have entered a new era in corporate governance in the past decade and should be allowed to make this decision.[116] However, a nonreviewable decision will most likely not be as thorough as a reviewable one. Thus, the courts must allow shareholders to effectively question those decisions and be willing to assist in a review of them when allegations are made that the board has failed to adequately protect the interests of shareholders.

Boards should have the freedom to offer executives protection in the event of a change in control, but golden parachutes should not become standard in executive contracts. Executive compensation should not be revised in response to a takeover threat and remuneration should not increase or extend for a period in excess of two years in the event of dismissal. Full disclosure of the provisions, as well as other components of executive compensation, is necessary so that the media and financial analysts can inform unsophisticated investors of the levels and implications of the contracts. If the current publicity, derivative suits and proxy challenges do not result in adequate board scrutiny of these contracts, the SEC should consider specific restrictions on these contracts. At the present time, however, the harm of golden parachutes has not been adequately quantified to justify governmental regulation as a replacement to the decision of an elected board of directors.

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116. Despite criticism of boards of directors, there seems to have been significant changes in corporate governance within the last decade. Selection of members is now broader, more time is spent on board decisions and the threat of lawsuits have all resulted in more activist boards. *See generally* Ellig, *Compensating the Board of Directors*, COMPENSATION REV., 3rd Quarter 1983, at 15-17.